

KIAWAH ISLAND UTILITY, INC.

DOCKET NO. 2001-164-W/S

PRE-FILED REPLY TESTIMONY OF JOHN F. GUASTELLA

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Testimony Prepared: March 8, 2002

Hearing Date: March 13, 2002

THIS TESTIMONY IS FILED PURSUANT TO PSC ORDER DATED JANUARY 15, 2002. THE APPLICANT RESERVES THE RIGHT TO SUPPLEMENT THIS TESTIMONY IN RESPONSE TO THE SURREPLY TESTIMONY THAT MAY BE PRE-FILED BY THE COMMISSION STAFF AND INTERVENORS.

Mr. Walker: Mr. Guastella, have you previously submitted prefled direct testimony in this Docket?

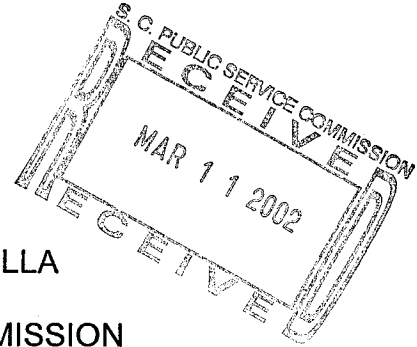
Mr. Guastella: Yes.

Mr. Walker: Have you reviewed the prefled testimony of the Intervenors and PSC Staff witnesses?

Mr. Guastella: Yes.

Mr. Walker: Do you have any comments with respect to the testimony of Mr. Walter T. Cuthbert?

Mr. Guastella: Yes. Aside from the absence of any appropriate cost analysis to support his opinions, Mr. Cuthbert's position is contrary to the establishment of an equitable recovery of costs from the various customer classes. In particular, the proposed standby rate is



designed to have the golf courses, that would sporadically impose major water demands on the Company's facilities, pay for the costs of having those facilities available to do so. Otherwise, all other customers would subsidize the cost of providing such service to those golf courses. This is not an issue between the golf course customers and the utility or its stockholder. Instead, it is an issue as to whether all customers pay their fair share of the cost of service.

Mr. Walker: Do you have any comments with respect to the prefiled testimony of Mr. Russell A. Hissom?

Mr. Guastella: Yes. Mr. Hissom's testimony is in error with respect to economic and rate setting principles, and is not supported with any quantitative analysis or theory.

Mr. Hissom's description of the "typical" developer/utility relationship is inaccurate. Mr. Hissom completely ignores the — fact that real estate is sold at market value, and the costs a developer incurs merely determine its profits in an unregulated, high risk business. The creation of KIU is, indeed, typical in comparison to the hundreds of developer-related utilities that I regulated and the hundreds for which I provided consulting services. As newly formed developer related utilities with no financial history, the affiliated developers, not only typically but invariably provide funds as an investment in the utility. While a

portion of the cost of certain assets may be contributed in some instances, there is absolutely no regulatory or economic basis upon which to force contributions if the utility rates are to be fully compensatory. Contrary to Mr. Hissom's testimony, on pages 3 and 4, there has never been a requirement that the entire utility plant infrastructure be contributed and only in the future would the utility earn a return on the utility plant after it has been replaced. Moreover, I am not aware of any investor-owned utility that has, with or without regulatory approval, charged impact fees on undeveloped property, as Mr. Hissom recommends.

Mr. Hissom's suggestion to deny a return ("interest") on KIU's plant in service that was obtained from its affiliate, would be a blatant violation of a rate setting requirement that utilities must be given a return adequate to maintain financial viability and attract capital.

Mr. Hissom's suggestion (page 8) to seek another third party review of certain costs is unnecessary. All of KIU's costs are now exhaustively scrutinized by its regulator, the Commission.

While Mr. Hissom acknowledges that some management services are provided by KIU's parent, he recommends nothing at this time. He is obviously not at all concerned about cost recovery.

Finally, there is no need for Mr. Hissom's proposed depreciation adjustment. The proposed depreciation expense does not include any depreciation related to the tap fees.

Mr. Walker: I realize that with the time constraints of having the PSC Staff testimony and exhibits for only one day, you cannot address each and every adjustment in detail. Would you, however, briefly outline the significant Staff adjustments with which you disagree?

Mr. Guastella: Yes.

Contributions in Aid of Construction:

Staff includes \$1,512,920 of CIAC in its rate base calculation. Staff is apparently unaware of the fact that considerably more than \$1.5 million of distribution mains were transferred by KRA to KIU for which no cost was booked. Thus, the CIAC level established in previous rate cases has in fact been treated as CIAC by not including at least that amount in KIU utility plant accounts. Staff's adjustment is in effect a double deduction. The correction to Staff's rate base also requires a correction to related depreciation expense and Staff's interest synchronization allowances.

I would also note that despite the interest synchronization, under an operating margin approach, the interest allowance should not be less than at least the actual level of interest expense.

Management Fees:

Staff's adjustments to management fees fail to consider all items because Staff limits its allowance to only the salaries that were based on time estimates. There were other partners

involved for which time estimates were not included. No allowances were made for vacation and sick leave. There are office costs for space, equipment and furniture that were not included. More importantly, there is absolutely no recognition of the value of the management services. Without the sharing of personnel and costs, made possible only by the existence of the affiliate, there would be no ability to receive such a wide range of services without hiring several people on a full-time or consulting basis, and providing related office space, equipment and furniture. Despite what is asserted on page 12 of Ms. Scott's testimony, there is no "duplication of services". Moreover, contrary to there being a "lack of a sufficient way of gauging participation by partners or directors," and contrary to a "lack of proof of the overall reasonableness", I submitted prefiled direct testimony and specifically show, on Schedule A.4, that compared with other utilities, KIU's overall labor, including management fees, are below average.

Engineering Services:

While I agree with Staff's proposal to amortize the engineering services related to the cost of water supply studies, Staff's proposed capitalization and depreciation over 40 years is unreasonable and unrealistic. The Staff allows only \$978 on a current basis for a \$39,102 cost. Such studies and / or similar studies should be performed at least every 5 years if the Company is to provide reliable service. I, therefore, recommend a 5 year amortization period.

Rate Case Expenses:

Staff has limited its allowance for rate case expenses to the

amount billed at the time of the preparation of its testimony. The Company will provide, at the hearing, all the actual invoices to date, which will support the level proposed in KIU's filing.

Unamortized Balances:

Staff has not included any unamortized balances in rate base, failing to recognize the time value of money. Just as working capital allowances or interest paid on customer deposits reflect the concept that the time value of money is a cost, the amortization of costs incurred and paid on a current basis produces an inescapable carrying cost that is properly included as a revenue requirement. The recovery of this cost is properly recognized by including the average unamortized balances in rate base. The items Staff has amortized include engineering and consulting services, legal fees, rate case expenses and Y2K studies. The total current expenditures for these items is over \$110,000 of which Staff is including only about \$35,000 on a current basis.

Used and Useful:

Staff's calculation of its used and useful adjustment is incorrect because it simply fails to recognize that the Ocean Course Drive extension could be no smaller or less costly if installed to serve only existing customers. Moreover, KIU must be able to serve new customers upon request. Staff's calculation of used and useful would, in theory, prohibit KIU from meeting that obligation on a least cost basis.

Mr. Walker: Does that complete your reply testimony at this time?

Mr. Guastella: Yes.

END OF REPLY TESTIMONY